

Pause in Economic Expansion Continues

Probability of an Approaching Upturn Mounts

THE FIRST HALF of 1967 interrupted the upward trend of spending, production, and employment that began in 1961. This pause, however, came at an historically high level of output with a low level of unemployment, and it followed a period of intense total demand, pressures on productive capacity, and price inflation.

Fiscal developments in the first half of this year were even more stimulative than in the last half of 1966, and monetary expansion was quite rapid. Such stimulative developments, unless offset by extremely high rates of private saving or sharp contractions in desired private investment, suggest an approaching renewal of last year's excessive demands on resources and loan funds.

The pause in economic expansion in early 1967 was indicated by slower growth or declines in spending, production, and employment. Despite declines in some price indexes, the general level of prices rose at an estimated 3 per cent annual rate during the first half of 1967. These recent developments contrast with previous trends. Spending and production expanded at a moderate rate from 1960 to 1964 with general price stability; the expansion then accelerated from 1964 to 1966, and prices rose sharply.

Total Spending Increases at a Slower Rate

Aggregate measures of spending and production indicate a deceleration of growth in the first half of 1967 (Table I), particularly in comparison with the rapid rates of growth from 1964 through 1966. Total spending measured in current dollars (nominal GNP) rose at an estimated annual rate of 4 per cent in the first half of 1967, about half the average rate for the two previous years.

Most of the recent more moderate growth in spending reflected higher prices. These price increases occurred despite less intensive use of productive capacity, and were chiefly a lagged, cost-push response to the excessive demands of last year. All prices do not rise immediately as demands increase. Some prices, such as most union wages, must wait until termination of contracts, while others are retarded by factors such as custom or public opinion. Increases in some prices, in turn, put cost-push pressures on other prices.

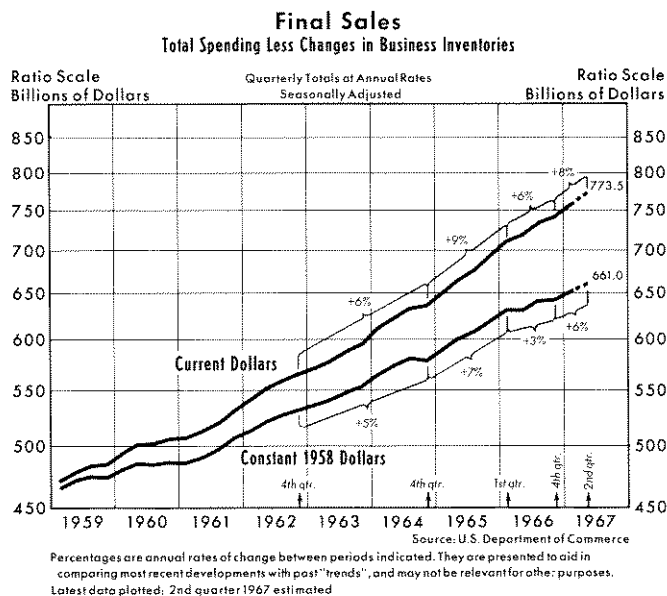
Since the growth in spending was nearly matched by price mark-ups, output and sales of physical units (real GNP) rose at an estimated 1 per cent rate in the first half of 1967, down sharply from a 6 per cent rate from 1964 to 1966. This measure, which is adjusted for changes in price levels, showed a slight net de-

Table I

TOTAL SPENDING AND PRODUCTION (Compounded Annual Rates of Change)

	4th qtr. 1966 to 2nd qtr. 1967*	4th qtr. 1966 to 1st qtr. 1967	1964 to 1966	1960 to 1964
Current Dollars				
Total Spending (Nominal GNP)	3.8%	2.3%	8.2%	5.8%
Final Sales (Total Spending less Changes in Business Inventories)	8.4	8.4	7.7	5.8
General Price Index (Implicit Price Deflator)	2.8	2.8	2.4	1.3
Constant Dollars				
Total Output (Real GNP)	1.0	- 0.3	5.7	4.4
Final Sales	6.0	6.1	5.2	4.4

*estimate for second quarter 1967



cline from the fourth quarter to the first quarter, the first such decline in about six years. This decline was more than offset by the second quarter increase, according to tentative estimates.

Final Sales Strengthen, Countering Inventory Drag

Attempts by businesses to reduce their inventories from undesired high levels reached in late 1966 were a chief factor contributing to the deceleration of total spending. Final sales, total spending less changes in business inventories, exhibited continued strength in the first half of 1967. This measure of economic activity may be a more dependable indicator of basic economic trends than total spending. These sales rose at an estimated 8 per cent rate in the first half of 1967, up from a 6 per cent rate in the last three quarters of 1966. Part of this rise reflected price increases. Final sales, adjusted for price changes, have grown at an estimated 6 per cent annual rate since late 1966, compared with a 5.2 per cent rate during the preceding two years.

Retail sales, which primarily reflect consumer spending, rose at a 5 per cent rate from January to May, about twice as rapidly as in the preceding year but much more slowly than in the period from early 1965 to early 1966. Sales of nondurables increased quite steadily in recent months, while sales of durables declined.

Sales to the Federal Government, as indicated by the national income accounts budget, have risen at a 20 per cent rate since the fourth quarter of last year, up from the already rapid 15 per cent increase in 1966 and the moderate 4.5 per cent average rate from

1960 to 1965. Sales at the wholesale level, which in part reflect business actions with respect to inventories, rose slightly from February to April, but are little changed from their year-ago level. Manufacturers' shipments, down from their December peak, are only slightly more than a year ago.

Business inventories, which have acted as a damper on total spending, may be approaching desired levels, at least in some industries. Wholesale and retail inventories, for example, have declined since January. In contrast, manufacturers' inventories, particularly of durable goods, have continued to rise. Much of this build-up, however, has been in work-in-process and may reflect rising new orders and production of defense goods as well as unplanned increases in raw materials or finished goods.

Industrial Production Slows, Construction Holds Steady

Largely in response to the earlier easing in sales and inventory build-ups, industrial production was weak through May. Production contracted at a 5 per cent rate from its December peak and is little changed from its level last spring. In contrast, this production rose at a 5 per cent rate from 1960 to 1964 and then accelerated to a 9 per cent rate from 1964 to 1966. The current level of industrial production thus remains relatively high. Production of durables showed the largest change, declining at a 5 per cent rate from January to May after growing at an 11 per cent rate from 1964 to 1966.

The rate of new construction expenditures has remained relatively stable since last summer. These expenditures declined markedly in the spring of 1966, after rising sharply from late 1964. The current level is about the same as in 1965 and above the average for the early 1960's. New housing starts, which fell sharply from December 1965 to September 1966, have risen noticeably since last fall. The May 1967 figure, 1.3 million units, is the highest recorded so far this year, but remains well below the average for the early 1960's.

Personal Income Continues Upward, Employment Slackens

The general slowdown in economic expansion in late 1966 and early 1967 has had relatively mild effects on personal income and employment. Personal income grew at a 5 per cent rate from January to May, down from an 8 per cent increase during 1966. The rate of growth in early 1967 was about the same as the average from 1960 to 1964.

Employment remained generally steady through the first five months of 1967. Payroll employment has been about unchanged since January, after increasing 4.5 per cent in the preceding twelve months. Rising employment in Government and services was almost sufficient to offset declines in manufacturing and construction. Total civilian employment declined at a 4 per cent rate from January to May, but there was an almost compensating decline in the civilian labor force, leaving the unemployment rate almost unchanged at 3.8 per cent of the labor force in May.

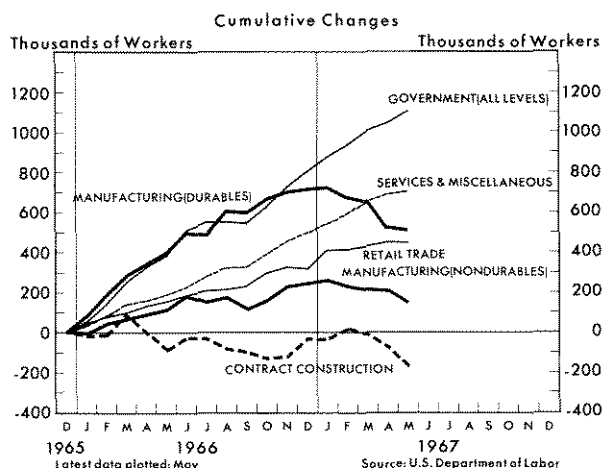
While the level of employment has been substantially maintained, overtime work and pay have declined. Some employers apparently tried to retain experienced workers during the slowdown in anticipation of possible future labor shortages.

Prices Continue to Rise

Most prices continued to rise in early 1967, but at slower rates than in the first half of 1966 (Table II). Consumer prices have risen at a 2 per cent rate since January, down from a 4 per cent rate in the corresponding period last year. Prices of consumer non-durables (excluding food) have risen more rapidly than prices of durables. Prices of services have continued to rise sharply, offsetting a reduction in food prices. Wholesale prices have been declining since late last summer, reflecting a sharp drop in some agricultural prices and a moderation in the rate of increase in prices of industrial commodities. The general price index of the national income accounts has continued to rise at an estimated 3 per cent annual rate.

All Civilian Employees on Nonagricultural Payrolls

Establishment Data, Seasonally Adjusted



Fiscal and Monetary Policies Become More Stimulative

The pause in the real growth of the economy occurred despite expansive Government fiscal actions. The high-employment budget deepened to an estimated \$9 billion deficit (annual rate) in the first half of 1967, compared with a \$2 billion deficit in the last half of 1966. These deficits contrast sharply with the average surpluses of \$12.6 billion for the period 1960 through 1963 and \$4.3 billion for 1964 through mid-1966. The high-employment budget is based on estimated Government receipts and expenditures at a high-employment level of income. It is designed to measure the influence of current Federal tax rates and expenditure plans on total spending.

The national income accounts budget reached an annual rate of deficit estimated at \$12 billion in the first half of 1967, the largest deficit since the recession period of 1958. Federal Government expenditures rose to an estimated \$160 billion annual rate in the first half of 1967, continuing the sharp rise since 1965. These Government expenditures represented 20.9 per cent of total GNP in the first half of 1967, compared with 18.7 per cent in 1964.

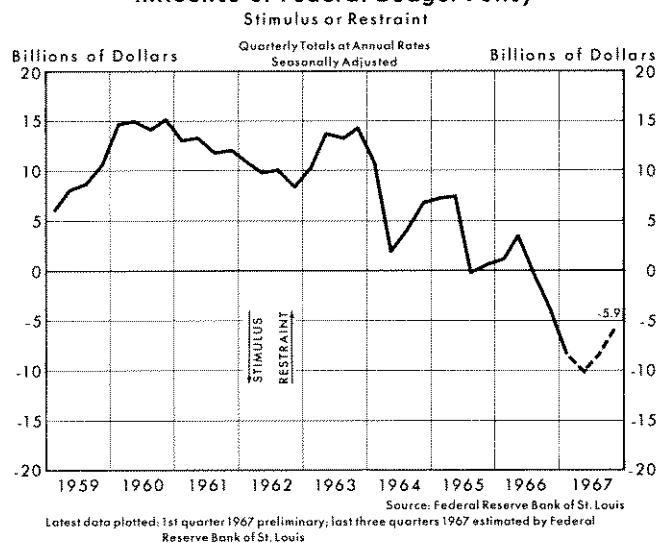
Federal Government expenditures rose at a 17 per cent annual rate from 1965 to mid-1967. Defense spending rose at a 24 per cent rate,

Table II

CONSUMER AND WHOLESALE PRICE INDEXES (Compounded Annual Rates of Change)

	January 1967 to May 1967	January 1966 to May 1966	1964 to 1966	1960 to 1964
Consumer Price Index				
All Items	2.4%	4.4%	2.3%	1.2%
All Commodities	1.6	4.0	1.9	0.8
Food	- 2.1	5.8	3.6	1.2
Commodities Less Food	4.0	2.9	1.0	0.7
Durables	3.5	1.8	-0.2	0.5
Nondurables	4.7	3.7	1.9	0.8
Services	3.6	5.1	3.0	2.0
Rent	1.9	1.4	1.2	1.1
Services Less Rent	3.8	5.8	3.4	2.2
Wholesale Price Index				
All Commodities	- 1.1	2.9	2.7	0
All Industrials	0.6	3.5	1.7	0
Farm Products	- 5.5	0	5.8	-0.7
Processed Foods and Feeds	- 5.5	0.8	4.7	0.8

Influence of Federal Budget Policy



while other Federal Government expenditures rose at a 12 per cent rate. In contrast, personal consumption plus private investment rose at a 5 per cent rate over the same period.

Monetary policy has been expansionary since late last year, as evidenced by the March reductions in reserve requirements on some time deposits, the lowering of the discount rate in April, and—most importantly—the rapid increase in Federal Reserve holdings of Government securities (Table III). By thus providing for an increase in the reserve base, the Federal Reserve has fostered growth in money and bank credit, thereby stimulating private spending.

Since the first of the year, both the money stock and total bank credit have grown at relatively high annual rates, 7 per cent and 12 per cent, respectively, according to current estimates. In contrast to a year

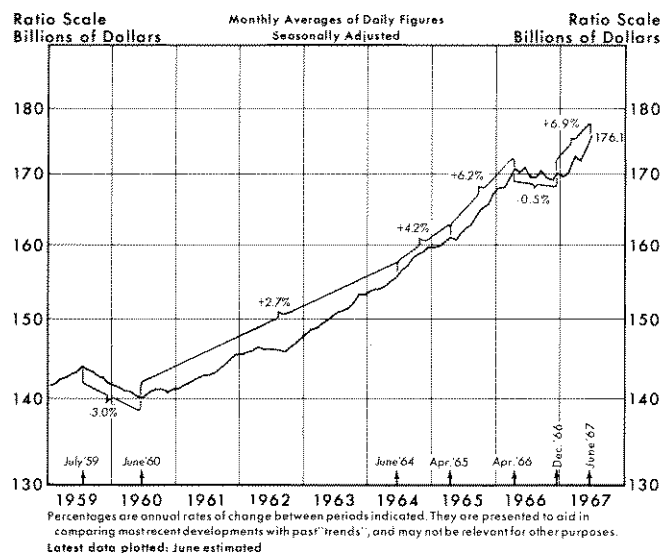
Table III

MONETARY AND CREDIT AGGREGATES (Compounded Annual Rates of Change)

	December 1966 to June 1967*	1964 to 1966	1960 to 1964
Federal Reserve Holdings of Government Securities	18.1%	9.7%	7.7%
Total Reserves	10.3	4.5	3.8
Reserves Available for Private Demand Deposits	6.8	2.7	1.6
Money Stock	6.9	4.2	2.6
Money Stock plus Time Deposits	12.2	8.3	7.1
Bank Credit (Daily Average)	11.6	9.3	7.9
Total Loans	6.8	13.4	9.3
Total Investments	21.9	2.2	5.9

*estimate for June 1967

Money Stock



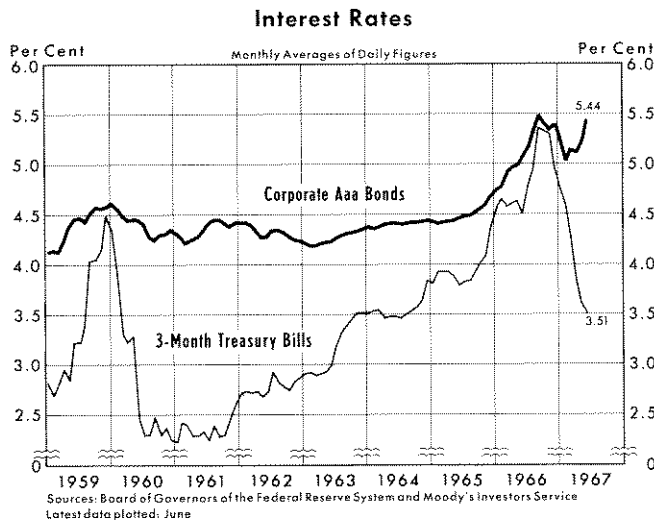
ago, credit has been readily available to most borrowers. Since rapid expansions of money and credit generally have their chief effect after a few months' lag, the stimulative monetary actions of early 1967 may be just beginning to influence the economy.

Spread Widens Between Short-Term and Long-Term Interest Rates

Short-term interest rates declined sharply during the fall and winter months, but have risen in recent weeks. Long-term interest rates, in contrast, have been rising since early 1967 and may have reached or surpassed their 1966 peaks. The widening of the spread between short-term and long-term interest rates in the first half of 1967 apparently reflected expectations of borrowers and lenders that interest rates in general would be higher in the future. Long-term borrowers may have taken advantage of increased availability of funds to restore their liquidity, partly because of uncertainty as to the impact of future Treasury borrowing to finance the fiscal 1968 Federal deficit.

Individuals and Firms Rebuild Liquidity

Partly in response to last year's credit squeeze, consumers and businesses have been increasing their liquidity. The slower growth in spending has been accompanied by a higher rate of personal saving than has occurred in recent years. Personal saving rose to 6.5 per cent of personal disposable income in the first quarter of 1967 and apparently remained above 6 per cent in the second quarter. These saving rates compare with an average rate of about 5.4 per cent from 1960 through 1965. The more rapid flow of funds to commercial banks, savings and loan associations, and other



financial institutions since late last year may reflect, in part, the increased rate of personal saving.

A year ago, financial institutions sought funds quite aggressively. Rates on certificates of deposit (CD's) and savings and loan shares pressed against regulatory ceilings as these institutions tried to obtain funds to meet intense loan demands, at a time when competing investments offered higher returns. In the first half of 1967, this situation was substantially reversed. Deposits flowed into financial institutions more rapidly, enabling these institutions to increase their liquidity.

Total time and savings deposits at commercial banks rose at a rapid 17 per cent rate in the first half of 1967, compared with a 10 per cent rate during the first eight months of 1966, and essentially no growth during the remainder of the year. The lack of growth in total time deposits in late 1966 reflected a substantial run-off in large negotiable CD's from August to early December, offset by continued growth in consumer-type time and savings deposits. The large CD's, which generally represent business rather than personal funds, rose at a 21 per cent annual rate from 1964 to 1966. Beginning in mid-December, banks were again able to attract CD funds. The amount outstanding rose to its previous peak in early February, continued to advance through early April, but has shown little net change since the April tax and dividend date. Offering rates on large negotiable certificates of deposits have remained below the Regulation Q ceiling rate since the beginning of the year, particularly for CD's with short maturities. There have been selected increases in recent weeks, but rates generally remain below their earlier levels.

Savings and loan shares increased at an 11 per cent annual rate in the first five months of 1967, compared with an extremely low 3 per cent increase during 1966

and a 12 per cent average rate from 1960 to 1965. Time deposits at mutual savings banks rose at about a 10 percent rate in early 1967, up from a 6 per cent rate in the preceding two years.

Total bank credit rose at a rapid 12 per cent annual rate in the first half of 1967. Loans outstanding grew at a 7 per cent rate, while bank holdings of marketable securities rose at an extremely rapid 22 per cent rate (Table III). These diverse movements may reflect some weakening in loan demand as well as the desire of banks to increase their liquidity positions from the low levels of late last summer.

Corporations apparently have concentrated their efforts to acquire funds by issuing new securities rather than by borrowing from financial intermediaries. Business loan expansion, at an 11 per cent rate in the first half of 1967, has slowed from the exceptional 17 per cent rate from 1964 to 1966. The rate of growth in business loans, however, remains well above the 7.5 per cent trend rate from 1953 to 1964.

Commercial paper rose at an unusually rapid 40 per cent annual rate in the first five months of 1967, surpassing the 19 per cent annual rate from 1964 to 1966. New corporate security offerings have also been extremely large in early 1967. Firms are apparently borrowing more than their current needs while funds are available, in order to avoid the type of liquidity squeeze experienced last year. Some of the new long-term funds have been invested temporarily in short-term instruments or have been used to refinance existing debts. Individuals' holdings of liquid assets have also increased rapidly, and consumers have been increasing their new debt at a much slower pace than in the past few years. Total consumer debt increased at a 4.5 per cent annual rate from November to April, compared with an 11 per cent rate a year earlier.

Summary

While sluggishness in total spending and production has continued in recent months, levels of output and employment remain high. The rapid rates of increase in prices of last year have only slightly moderated. In many respects, the recent moderation of growth in spending represents a desirable change from the over-expansionary and inflationary situation of 1965-1966.

Several factors point to the possibility of renewed rapid growth in total demand later this year. Fiscal and monetary developments, which are generally thought to influence total spending after some lag, have been highly stimulative this year. Final sales continued to expand rapidly in early 1967. As the inventory ad-

justment is completed, growth in total spending is likely to accelerate. Savings and liquid asset holdings of individuals have increased at greater than customary rates. This may be a reaction to recent economic and political uncertainties, a hedging which may be terminated at any time, leading to an acceleration in personal spending. Businesses apparently have been

proceeding more cautiously in response to relatively large inventories and the deceleration in private spending, but remain optimistic about future expansion. Banks, in particular, are increasing their ability to meet a recurrence of last year's surging loan demands by acquiring larger amounts of marketable securities.

